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C O N F I D E N T I A L SECTION 01 OF 02 CARACAS 000487

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E.O. 12958: DECL: 04/04/2018
TAGS: EPET ENRG EINV ECON VE
SUBJECT: CONOCOPHILLIPS BRIEFS AMBASSADOR ON COMPENSATION
NEGOTIATIONS

Classified By: Acting Economic Counselor Shawn E. Flatt for Reason 1.4
(D)

¶1. (C) SUMMARY: ConocoPhillips (CP) is guardedly optimistic on the state of negotiations on compensation for its expropriated assets in Venezuela. May will be the key month for negotiations. CP and the BRV have reached agreement on the methodology for determining the fair market value of CP's assets. High oil prices will increase the amount of CP's compensation claims. CP prefers to do receive assets instead of cash. It hopes to receive three Citgo refineries in the United States. END SUMMARY

NEGOTIATIONS ARE PROGRESSING

¶2. (C) CP President for Strategy, Integration, and Specialty Businesses Greg Goff and Latin America President Roy Lyons (strictly protect both throughout) briefed the Ambassador on April 4 on the state of compensation negotiations with the BRV. Goff began the meeting by stating he was a "little optimistic". He said May was the "crunch time" for the negotiations. CP would like to do a trade for Citgo assets if possible and negotiations have been moving in that direction. PDVSA claims it has enough cash on hand to pay off CP's claims but CP has its doubts.

¶3. (C) Goff explained that May is the key date for CP due to the fact that it has to submit is official claims to the arbitration panel in June. CP's claims run in the tens of billions of dollars. Lyons noted that the claims have increased recently due to recent increases in oil prices.

¶4. (C) According to Goff, CP has two basic claims: a claim for compensation for its expropriated assets and a claim based on the progressive expropriation of the underlying assets. Goff stated the BRV has accepted that fair market

value is the standard for the first claim. He said the BRV has moved away from using book value as the standard for compensation and has agreed on a fair market methodology with discount rates for computing the compensation for the expropriated assets. However, given the recent increase in oil prices, the fair market value of the assets has increased.

¶5. (C) As for the claim based on the progressive expropriation of the assets, Goff said the claim was on top of the fair market value of the assets. CP has proposed a settlement number and the BRV appears to be open to it. Goff added that CP also plans on increasing the settlement number for the second claim due to recent increases in oil prices.

CP WANTS ASSETS RATHER THAN CASH

¶6. (C) Goff stated CP has been looking at cash compensation for its claims as well as a trade for Citgo assets. For the past six weeks, CP personnel have been doing due diligence on Citgo assets in order to determine their value. Goff said CP has a clear preference for an asset swap rather than cash compensation. Since Citgo has not properly maintained its refineries, CP believes they contain considerable hidden value.

¶7. (C) When the Ambassador asked whether compensation in the form of Citgo refineries carried risk due to the need for supply contracts, Goff agreed. He stated CP is looking at three Citgo refineries. Two of the refineries, Corpus Christi and Lake Charles, are located on the Gulf Coast and are designed for Venezuelan heavy crude. The third refinery

is outside Chicago and is tied to Canadian oil sands production. (Note: We believe Goff is referring to the Lemont Refinery. End note). He noted that if CP owned both Gulf Coast refineries, it would end up with 75% of Venezuelan crude exports to the United States.

¶8. (C) Although Goff admitted that there was supply risk associated with the Gulf Coast refineries, he stated CP could reduce its risk by selling one of the refineries. Goff said Petrobras and Koch Industries were both possible suitors for one of the refineries. The Corpus Christi refinery is located next to a Koch Industry refinery. Goff opined that it would be relatively easy for Koch to integrate the refineries' operations. He added that the Lake Charles refinery is located next to a CP refinery and would be a good fit for CP. According to Goff, the Lake Charles refinery comprises 40 to 50% of Citgo's total assets.

¶9. (C) Goff stated supply risk is mitigated to some extent by Venezuela's proximity to the U.S. market as well as the fact that there are a limited number of refineries worldwide that can handle Venezuelan heavy crude. He added that it is difficult to change refinery configurations to handle Venezuelan heavy crude. He later admitted a major new refinery in India could take some. Lyons later opined that one way to further reduce supply risk is to keep PDVSA as a minority partner in the refineries.

¶10. (C) Goff stated an asset swap may be of interest to the BRV since it is adamant that it wants to reduce its asset base in the U.S. He then reiterated his belief that the next two to three months is the window of opportunity for a deal.

COMMENT

¶11. (C) As Goff pointed out, an asset swap makes a great deal of commercial sense for CP. Faced with years of arbitration, questions regarding PDVSA's ability to pay cash compensation due to its cash flow problems, and the significant upside potential of the Citgo refineries, CP has a clear interest in taking assets instead of cash. On the other hand, giving up

Citgo's refineries, which comprise the heart of the company, will come at a real cost to the BRV. Although President Chavez has repeatedly stated for years that he wants to reduce PDVSA's exposure to the U.S. market, Citgo has proved to be a real asset to the BRV and PDVSA. In addition to the substantial dividends that it has remitted to PDVSA, Citgo's heating oil program for the poor has served as a valuable propaganda tool for the BRV. In addition, PDVSA has used Citgo in the past to secure financing on better terms than PDVSA itself can receive. We find it hard to believe that senior BRV and PDVSA officials are unaware of the high cost of an asset swap. The real question, as always in Venezuela, is whether President Chavez is aware of the actual cost of giving up Citgo's refineries.

DUDDY